STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS COMMERCE COMMISSION, On Its Own Motion,	)	
v.	)	**ICC Doc. No. 00-0340**
ILLINOIS-AMERICAN WATER COMPANY,	)	
Proposed general increase in water rates	)	

REPLY BRIEF OF THE CITY OF O'FALLON, CITY OF FAIRVIEW HEIGHTS AND VILLAGE OF CASEYVILLE BEFORE THE HEARING EXAMINER IN RESPONSE TO THE RATE APPLICATION OF THE ILLINOIS-AMERICAN WATER COMPANY [*]

I. THE RATE OF RETURN TO THE WATER CO. SHOULD BE LIMITED TO A LOW RISK INVESTMENT LEVEL.

As demonstrated in the initial brief of the City of O'Fallon, the City of Fairview Heights and the Village of Caseyville (herein cumulatively "the City of O'Fallon"), the burden of proving each element in a rate proceeding rests on the rate applicant. If the applicant does not carry its burden of proof, there is nothing for the other parties to address or for their evidence to respond to. The Illinois-American Water Co. (herein "the Water Co."), the rate applicant in this proceeding, therefore, had the burden of proving the reasonableness of the return it seeks. No other party can relieve the Water Co. of this burden. It is up to the Water Co. to make the case for the reasonableness of the return. Failure to carry this burden should lead to denial of each component of the rate of return not proven to be reasonable by the Water Co. (O'F. Br., pp. 2-4.)

[*] All references to the various parties' briefs herein are to their respective initial briefs.

The unrebutted Commission Staff (herein "Staff") adjusted 6.96% cost of long-term debt and the 6.25% agreed cost of preferred stock (ICC Br., p. 9) generally reflects the low risk nature of the Water Co.'s business. These rates of return show a perceived similarity between the Water Co.'s protected business status and the "risk free" nature of the U. S. government. The City of O'Fallon will not further address the Water Co.'s debt instruments.

In regard to the cost of common equity, however, the City of O'Fallon joins the Staff and the Illinois Industrial Water Consumers (herein "the IIWC") in challenging the Water Co.'s cost of common equity. But unlike these other parties, the City of O'Fallon does not proceed from the assumption that the cost of common equity for this governmentally protected Water Co. need include a "risk premium" component. The City of O'Fallon continues to resist the substitution of an implied and unexamined assumption that there are real risks endemic to an investment in the common equity of this particular Water Co. for a factual evidentiary demonstration of actual experience of uncompensated loss or concrete threat of an impending uncompensated loss.

The City of O'Fallon also challenges the complete reliance placed by others on financial theory and artificial models in lieu of real world, objective, factual, directly comparable evidence. The amount of "risk premium" that would be reasonable for this particular Water Co. should have its basis in fact, not in subjective opinion and *ad hoc* creations. Hypothesis, theory, and conjecture do not satisfy the burden to produce relevant, competent proof.

The record remains devoid of evidence that any of the risks listed in the Water Co.'s testimony, other than competition, actually impacts this particular Water Co. And, competition as stated in O'Fallon's initial brief should minimize return.

There is no evidence of any loss having ever been visited on its shareholder. The record also remains devoid of evidence showing that wholly privately owned and untraded common equities, such as that of the Water Co., gives rise to the same cost of equity (*e.g.*, has the same nature, requirements, synergy and dynamics as market-traded stocks) as market-traded common equities. Yet, the other parties' sole reference is to market-traded common equities, elevating them to guides without any evidence of how these market-traded stocks may or may not be different from closely held non-traded common equities (*e.g.*, .ICC Br., p. 9). And to go still further, there has been no evidence showing that, or to what extent, the common equity of one company, which is wholly privately owned by an umbrella company that combines those shares with others from a multitude of other companies it wholly owns, affects the common equity of the umbrella company. Diversification, leverage, synergies and other factors, particularly where the individual constituent company's cash needs are governmentally protected and provided through rate approvals, may lead to quite different common equity requirements and behavior from individually market-traded common equity. Indeed, there is a recognition in the evidence that the Water Co. stock is not the equivalent or comparable to the market-traded equity of individual companies (IAWC, Ex. 7.0, p. 3; ICC Br., p. 11).

It is easy to get swept into the minutia of the arguments. But, unless there is direct comparability, the minutia remain meaningless. The forest should not be lost for the trees. Proof of comparability is missing. Indeed, the only evidence addressing comparability establishes the lack of it. Comparability cannot arise from amalgamating companies that are not comparable. The effort to transform the inherently noncomparable into comparability is no more effective than the alchemists' failures at turning lead into gold. The effort may serve advocacy, but it is not evidence. T h e confounded harlequin assortment of publicly traded stocks no more equals the privately held Water

Co. than Frankenstein's monster equaled a human being. The other parties' attempts to create a comparability cast only an illusion and craft only a fiction. There is no relevant, competent evidence on which to go forward and even consider a "risk premium" component to the rate of return.

But, even if proof were in the record of (1) actual risk having real impact on the Water Co., (2) comparability of closely-held common equity to market-traded common equity and (3) comparability of the common equity of an individual closely-held constituent component of an umbrella, conglomerated holding company with market-traded common equity of individual companies, there is no reliable evidence in the record which establishes what rate of "risk premium" would be reasonable. The law requires a real world factual demonstration of reasonableness drawn from the actual experience of comparably circumstanced companies. Although two companies may not be identical, the referent company should bear a close resemblance; differences between the referent company and the company before the Commission should be highlighted and adjusted for by a universally recognized, disciplined and principled methodology in much the same way that real estate appraisal practice arrives at an objective value of one parcel of real estate by comparing it to the value of closely analogous pieces of real estate. In the present proceedings, no actual, factual, real world comparability between the Water Co. and one or more other companies in closely analogous circumstances has been attempted.

One should expect a rate of return analysis to bear a much closer resemblance to a real estate appraisal than a doctorate thesis in theoretical economics. Reasonableness is an *ad hoc,* individual, fact sensitive legal standard. The reasonableness being sought is that for the rate applicant before the Commission, not a theoretical company on imagined circumstances or of a generalized industry as a whole. Indeed, treating the water supply industry, a regulated industry, as a whole, from an abstract

level, using only financial rates of return, leads merely to one commission looking to what other commissions have done, in a trunk to tail circularity. And, taking merely the high end of such companies as examples (as the Water Co.'s Mr. Moul appears to have done) merely causes the circle to become an increasing spiral.

The present record on the rate of return consists only of subjective and varying opinions and estimates. What is more, the record reveals that even these lack methodologic consistency. Looking beyond the initials or labels employed, one finds no universally accepted approach. There is no rule regarding whether historical data, present data or a mixture should be used (*e.g.*, ICC Br., pp. 19-21). There is no consensus as to what can be regarded as a proxy for the Water Co. (*e.g., compare,* IAWC, Ex. 7.0, p. 4, 23 with ICC Ex. 3.0, p. 10 with IIWC, Ex. 1.0, p. 14; IIWC Br., p. 25; ICC Br., pp. 13, 15-6). Each brief is a parochial and insular defense of the respective party's particular witness.[1]

Each party seeks to throw the other's baby out with the bath water. For instance, the Staff contends:

> The record demonstrates that Mr. McNally's recommendations concerning cost of common equity are based upon the valid application of sound financial theory, while Mr. Moul's are not.

(ICC Br., p. 9.) The Water Co., for its part, states that the various aspects of the Staff's analysis is "seriously-flawed" and "biased" (IAWC Br. *e.g.*, pp. 2, 38, 9), and the same is said of the testimony of IIWC's Mr. Gorman (IAWC Br,. *e.g.*, pp. 15, 16, 17). Pages of the IIWC's brief are devoted to criticizing Mr. Moul (IIWC Br., pp. 19-28). All is anarchy of opinion, rather than factual evidence; all is ultimately subjective. Each party's respective analysis starts with a choice of assumptions (not

[1] The closest that two parties come together is the IIWC and the Staff, but they are still divergent.

fact) which are manipulated through a chosen theoretical model, resulting in an opinion that estimates what the "risk premium" would be for a hypothesized company (*E.g.*, ICC Br., pp. 9, 11, 12, 13). Each party shoehorns its desired outcome into subjectively chosen referents and then euphemistically calls the result "judgment.".

The Staff admits:

> Staff Witness Michael McNally estimated the cost of common equity for I.A.W.C. [the Water Co.] with the DCF and risk premium models. *DCF and risk premium models cannot be applied directly to I.A.W.C.* because its common stock is not market-traded.

(ICC Br., p. 11 (emphasis added).) And, Staff also admits:

> All individual cost of equity estimates contain some degree of measurement error.

(ICC Br., p.13.)

Staff then states:

> Mr. McNally testified that a thorough cost of common equity analysis requires both the application of financial models and the analyst's informed judgment. A cost of common equity recommendation based solely upon judgment is inappropriate. However, because cost of common equity measurement techniques necessarily employ proxies for investor-expectations, judgment is necessary to evaluate the results of such analyses.

(ICC Br., p. 12.)

Mr. Moul admitted in his testimony that:

> All of the common shares of IAWC are owned by American Water Works Company, Inc. ("AWW"). This means that the standard models of the cost of equity cannot be applied directly to the Company due to a lack of stock prices.
>
> * * *
>
> Although the parent company is the source of new common stock equity for IAWC, the AWW market data has not been used directly

> to measure the cost of equity for the Company. This position has been taken because the determination of the cost of equity for an individual company has become increasingly problematic.

(IAWC, Ex. 7.0, p.3.) And, then states:

> Informed professional judgment is required only to interpret the results of this study....

(IAWC, Ex. 7.0, p.74.)

Eliminate the partisan subjective parsing of data and the shows of mental dexterity, and the record is left with only rationalization of the arbitrary, devoid of actual comparable factual evidence of what is a reasonable "risk premium" for the Water Co. specifically. In fact, Mr. Moul's testimony shows just how far the discussion of the "risk premium" component for the Water Co. common equity has strayed from the Water Co.'s actual circumstances. In discussing "the relative investment risk of a firm," Mr. Moul admits that "no single index or group or indices can precisely quantify the relative investment risk." He then proceeds to discuss factors that bear only upon investment securities publicly sold and traded (*e.g.*, bond ratings, price earnings multiple, dividend yield and data coefficient) none of which exists for the Water Co. as a wholly privately owned company (IAWC, Ex. 7.0, p. 20). The other indicator that he mentions as reflective of business risk is the rate of return on equity (IAWC, Ex. 7.0, p. 20), but since the reasonable rate of return on equity for the Water Co. is precisely the issue under consideration, at best this indicator is of no help, and at worst it is completely circular.

Mr. Moul states his concern to be that the rate of return enable the Water Co. to have access to the capital required to meet its service responsibilities to its customers (IAWC, Ex. 7.0, p. 6). But, attraction of capital sufficient to meet the Water Co.'s responsibilities over time is not a legitimate

concern in calculating the rate of return for this company that is wholly owned and obtains its capital needs from its parent.

Furthermore, it is not the duty of this Commission to make the Water Co.'s return equal to any other company. *Illinois Central R.R. Co. v. Commerce Com'n,* 359 Ill. 563, 195 N.E. 32, 35 (1935). It should only receive that return which is reasonable to its own, individual situation. Indeed, "[r]egulation may, consistently with the Constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness." *Permian Basin Area Rate Cases,* 390 U.S. 747, 769 (1968).

There are many other factors besides attraction of capital and related securities considerations that must be considered before an appropriate rate of return can be determined. As the United States Supreme Court held in regard to a federal rate case:

> The Commission cannot confine its inquires either to the computation of cost of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to access the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success at which they protect these interests as by the effectiveness with which they " maintain...credit and...attract capital.

Permian Basin Area Rate Cases, 390 U.S. 747, 791 (1968). Competitive forces and the damage that defections from the Water Co.'s system cause to remaining ratepayers are important reasons in this proceeding to keep the percentage of return, and therefore, the rate of which it is a part, to a minimum.

In the absence of competent evidence of both real risk and the reasonableness of the "risk premium" sought for the Water Co., there is no substantial competent evidence in the record to support a "risk premium" component to the rate of return. (And, if there were, it would be so iffy as to support only the most modest premium, only marginally above a "risk free" return on taxable government debt securities, and certainly *well under* 10%.)

In all events, what direct facts there are show that the rate of return that the Water Co. is already receiving is adequate, if not more than adequate. The Water Co. has been making acquisitions of other water companies in Illinois at an alarmingly rapid rate. The Company's acquisitions are direct testimony that the rate of return that it now enjoys is sufficiently attractive, without any increase, to lead it to expand greatly in Illinois. It would not do so if it did not have the funds to do so and if the acquisitions under the existing Illinois rate regime were not attractive and profitable. Also, the annual report for the Water Co.'s parent corporation, a conglomerate of water companies nationwide, shows that although the Water Co. was 6.74% of its parent's nationwide net utility plant on December 31, 1999, the operating revenue of the Water Co. were 7.71% of its parent's nationwide operating revenues for 1999.[2] The fact that the parent company makes a larger percentage of its revenue from Illinois where it has less of its utility plant implies that the Water Co. already enjoys a rate of return that is above its proper proportion. There is, therefore, no basis in the record for any "risk premium" component to the rate of return, and the rate of return should remain close to the rate paid on taxable government debt instruments and the Water Co.'s preferred stock.

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[2] Administrative notice should be taken of the American Water Works Company, Inc.'s 1999 annual report. As the Water Co. notes in its brief (IAWC Br., p. 11n), the Commission can take judicial notice of such facts as economic facts and financial facts. The annual report of the Water Co.'s parent corporation is easily referenced and its contents are representations by the parent company itself made to the public in conformity with federal securities laws.

II. WITHOUT A COST OF SERVICE STUDY, THIS COMMISSION IS LEFT WITHOUT INFORMATION NECESSARY TO JUDGE THE FAIRNESS, REASONABLENESS AND DISCRIMINATORY EFFECT OF THE RATE PATTERN. THE RATE APPLICATION SHOULD BE DENIED AND THE RATE CANCELLED.

Other partys' initial briefs confirm the evidentiary necessity of a cost of service study. For instance, the Staff explains in its brief:

> In general, a cost of service study ("COSS") is performed to allocate costs among all customer classes to determine each customer class' respective cost responsibility for the costs imposed on the utility by that specific customer class. Rates can then be designed with the knowledge of the cost to serve each customer class. In the water industry, COSS' are utilized as the main guide to designing rates.

(ICC Br., pp. 29-30.) Rates cannot be fairly and reasonably designed, nor judged by others for fairness, reasonableness and the absence of discrimination, if there is no factual base line against which to measure their conformity to these standards for each customer class. In order for a rate to be lawful, it must be fair, reasonable and non-discriminatory, and where the evidence fails to prove this, the rate application should be denied and the rates cancelled.

The necessity of a cost of service study to judging whether a rate pattern is legal and proper is demonstrated by the efforts of both the Water Co. and the Staff to claim conformity to one. The Water Co. states in its initial brief:

> The Company has proposed an across-the-board rate increase. In so doing, it has allocated revenue requirements in accordance with the cost of service allocations established in its most recent prior rate order....

(IAWC Br., p. 24.) The Staff similarly makes claim to a basis for its position in a cost of service study; in its initial brief, it states:

> Staff is the only party in this proceeding to perform a COSS for all districts

(ICC Br., p. 30.); and:

> Staff based their rates on a fully allocated COSS

(ICC Br., p. 34).

Despite the attempts by both the Water Co. and the Staff to clothe their respective positions in the color of a cost of service study, there has been no proper, accurate or reliable cost of service study performed by anyone for this proceeding. As pointed out in the City of O'Fallon's initial brief, the record shows that the Water Co. has gone through many changes since its last rate proceeding (O'F. Br., p. 12). No party, however, has done a study to investigate how these changes have affected the allocation of costs incurred among the customer classes served. Yet, witnesses have acknowledged that these changes in the Water Co. since its last rate proceedings could change the cost allocations among customer classes, rendering the cost of service study done for the Water Co.'s last rate application inaccurate and misleading in regard to the present rate application (Trans., 10/26/00, pp. 114-16, 10/30/00, pp. 281-82).

Although the Staff contends that it performed a cost of service study in this proceeding (ICC Br., pp. 30, 36), and based its rates on a fully allocated cost of service study (ICC Br., p. 34), the facts in the record show otherwise. Staff testimony establishes that to determine load factors and other aspects of the class specific allocation of water service cost incurrence requires an extensive study which can be very expensive (Trans., 10/26/00, pp. 141-42). The Staff testimony admits that the Staff did not undertake this extensive and expensive study. The Staff admitted that it merely took new expense figures and plugged them into old allocation data that had been used in the Water Co.'s

previous rate proceeding (Trans., 10/26/00, pp. 112-15). Because the objective of a cost of service study is not merely to chronicle costs, but to accurately determine how they have been caused to be incurred by particular customer classes, the Staff did nothing in the present proceeding in regard to the essential part of a cost of service study. The crucially important part, the allocation part, was no more than recycled, stale information taken "whole cloth" from the Water Co.'s previous rate application, with no independent test done for its accuracy in regard to the present rate proceeding. The present application should fail, and its rates should be cancelled, because the record fails to contain the cost of service evidence necessary to satisfy the burden of proving fairness, reasonableness, and non-discrimination.

Both the Water Co. and the Staff rely on the outdated allocation information. The Water Co.'s across-the-board proportional increase follows the old pattern of allocation. The Staff uses the old allocation information as the framework in which it plugs more recent cost figures. Staff's allocation is not any more accurate than the Water Co.'s, since both rely on the allocation of the earlier rate proceeding. Two things equal to a third are equal to each other. But if one's position can be said to be more accurate than the other's, it is the Water Co.'s position, simply because it is a direct reflection of the earlier cost of service study. It has not been further compromised, and its inaccuracies compounded, by Staff's mixture of new cost figures and old allocation data. But, neither is really competent to meet the burden in the present proceeding.

Had an actual study of cost allocation been done for the present rate proceeding, however, it still would not have been sufficient if its classification of customers remained the same as in the previous cost of service study. The attribution of costs is governed by the number and kinds of classifications recognized. For instance, each customer could be a class unto himself because each

customer causes the Water Co. to incur a different amount of cost as a result of his particular distance from the treatment plant, which either reduces or increases transportation costs. Virtually every customer could be found to cost the Water Co. a different amount. To take account of every minor difference, however, would create an impractical, unduly complicated and unmanageable rate structure. Recognizing that almost any difference could be considered the basis of a different classification which would affect the way that the cost of service is divided and attributed is helpful in recognizing that there is nothing absolute about how customers are classified. Subjective classification choices, not absolute objective reality, govern the outcome of a cost of service study. All calculations flow from the classifications drawn.

Customer classes should be based on significant distinctive characteristics which identify groups of customers as different from the other customers of the Water Co. (*e.g.*, residential users, industrial users). Wholesale-for-resale customers of the Water Co. have characteristics that are substantially different from retail customers (O'F. Br., pp. 14-5). Wholesale-for-resale customers absorb responsibility for costs that other classes of customers impose on the Water Co. Because wholesale-for-resale customers relieve the Water Co. of these costs, not reflecting this in a special rate would make them contribute to the same functions twice. A wholesale-for-resale classification would change the result of cost of service allocations in regard to the customers in that class, such as the City of O'Fallon.[3] Wholesale-for-resale is a well established and recognized classification[4] that

[3] The City of O'Fallon is clearly recognized as a wholesale-for-resale customer (IAWC, Ex. R-1, p. 9; Trans., 10/30/00, pp. 173-76; IAWC Br., p. 24).

[4] Manual M1 of the American Water Works Association, entitled PRINCIPLES OF WATER RATES, FEES, AND CHARGES (5th Ed.) *e.g.*, p. 64). Manual M1 is a recognized reference work in the field of water rates (*e.g.*, Trans., 10/26/00, p. 116, 10/30/00, pp. 282-83).

was never treated separately in the previous cost of service study piggy backed on by the Water Co. and Staff (*e.g.*, Trans., 10/26/00, pp. 61-2).

Because no cost of service study whatever was done recognizing wholesale-for-resale customers, there is no relevant, reliable, competent evidence in the record establishing that the rates applied for by the Water Co. are fair, reasonable and non-discriminatory to wholesale-for-resale customers, such as the City of O'Fallon.[5] The burden of proof on this matter has not been carried, and the rate application as to the City of O'Fallon and similar wholesale-for-resale customers should be refused approval and the rates cancelled.

An across-the-board uniform percentage increase, although better than the Staff's confounding of the new with the old, still magnifies the real dollar cost for larger water users, because the percentage would be applied to a base swelled by the much larger percentage increases that the third and fourth block rates have already experienced over the last several years (Trans., 10/26/00, pp. 49-50). Also much of the reason for seeking the increased rates is to be found in cost factors that should be shared by all ratepayers (Trans., 10/26/00, p. 48, 10/30/00, pp. 277-78; IIWC, Ex. 1.0, p. 22). This should be particularly unacceptable in light of the existing competitive forces (*see*, O'F. Br., pp.16-7; IIWC Br., pp.10-11, 4, 13). In the absence of reliable evidence against which fairness, reasonableness and discriminatory results can be realistically and reliably judged, no rate increase should be approved. But, if despite the lack of evidence, a rate increase is approved, it should be a very modest conservative one, not the major one, sought now, which follows on the heels of a

[5] Although, in the absence of any cost study to the contrary, intuition is that wholesale-for-resale customers, which relieve the Water Co. of costs it would otherwise bear, have a lower cost of service than retail customers. Yet, Staff, without any study that justifies the result, states that under the present rate application wholesale-for-resale customers will suffer at rate increase of 9.1 to 9.3 per cent while the larger user industrial class will suffer a lower, 6.8 to 7.5 per cent increase (ICC Br., p.35).

previous rate increase allowed only approximately two and one-half years ago. Any increase, but certainly such inflated ones, threatens to push additional water users within the water system to bolt that system and to use a cheaper, alternative source of supply. This would throw a heavier burden on the other customers within the system and could led to spiraling defections.

III. NO SUBSTANTIAL EVIDENCE ADDRESSES OR SUBSTANTIATES FAIRNESS, REASONABLENESS AND NONDISCRIMINATION OF SINGLE TARIFF PRICING. INDEED, THE EVIDENCE DEMONSTRATES THE UNFAIRNESS, UNREASONABLENESS AND DISCRIMINATORY NATURE OF SINGLE TARIFF PRICING IN THE INTERURBAN AND OTHER DISTRICTS OF THE WATER CO.'S TERRITORIES.

Each initial brief proceeds on the basis that single tariff pricing is a given. But, single tariff pricing is part of a rate pattern. As with other aspects of the rate pattern, it must be proven by substantial evidence to be fair, reasonable and non-discriminatory. Each rate application set for hearing must be supported by facts in the hearing record proving its fairness, reasonableness and non-discrimination in order to be approved. There has been no evidence, much less proof, in regard to the fairness, reasonableness and non-discrimination of single tariff pricing, and no party contends otherwise.

What the other parties do in their initial briefs, if they seek to justify single tariff pricing at all, is to hark back to Commission approvals of single tariff pricing in earlier Water Co. rate applications (*e.g.*, ICC Br., p. 31, 33). Had the Water Co. not gone through major changes by acquisition, increase in territory, *etc.* perhaps single tariff pricing would not have to be revisited, but there have been significant changes (*e.g.*, IAWC, Ex. 1.0, p.3; Trans., 10/30/00, pp. 281-82). Nothing, therefore, can be assumed. The lack of evidence on the issues of the fairness, reasonableness and lack

of discrimination in regard to the imposition of single tariff pricing should condemn the rate application to rejection and the rates to cancellation.

Additionally, Staff's adherence to single tariff pricing conflicts with its intention to promote cost of service as the guiding principle, and underlying goal, of any rate pattern (ICC Br., pp. 34, 36). And, the inclusion of the full cost of the Alton water treatment facility within single tariff pricing would violate both the underlying principle on which it is erected and which legitimates it — approximately equal reciprocity — and allocation on the basis of cost of service. None other than Alton district ratepayers directly benefit from the Alton water treatment facility, and that facility is enormously expensive. There is no evidentiary showing that other ratepayers would ever gain back any reciprocity approximating an equality from the Alton district ratepayers (*e.g.*, Trans., 10/30/00, pp. 167-71; IAWC, Ex. R-1, p. 8). Viewing the amount needed to construct the Alton water treatment facility as a percentage of the total construction budget for the period since the last rate application to the present, as well as a percentage of the total construction budget from the present to 2001 shows just how enormous and nonrecurring that facility's construction expense is.

As the Water Co. quantifies the expense in its initial brief:

> [A]s a result of the new treatment facility, the Company's net investment per customer in the Alton District exceeds its net investment per customer in the balance of the Southern Division/Peoria single-tariff pricing area approximately $1,800 (Company Exhibit SR-1, p. 3). As Mr. Stafford stated, "this differential supports the Company's concept of a 25 percent Alton source of supply charge based upon the approximate additional revenue requirements arising from the differential in net investment per customer." (Company Exhibit SR-1, pp. 3-4).

(IAWC, Br., p. 26.)

Staff contends, without citation to any record reference or other evidentiary source, that the Water Co. invested approximately $25.4 million in a water treatment plant between 1996 and 1997 for the Interurban and Peoria Districts. Also, without any record reference or other evidentiary source, Staff contends that this water treatment plant was included within the single tariff pricing. Where there is no evidence in the record, the representations cannot be considered or relied upon. Furthermore, in the absence of a record regarding these "facts," no analysis can be made regarding whether there was a differential by which that plant exceeded the net investment per customer, as the Alton facility incurred. It is clear that even if the unproven representations are taken as true, the Alton facility is approximately one-third greater than the treatment plant for the Interurban and Peoria Districts.

The Alton source of supply charge is also equitable, even if measured against the Staff's unproven history. The Water Co. did not eliminate the Alton water treatment facility entirely from single tariff pricing. It merely brought it within the philosophical level of approximately equal reciprocity, by setting the Alton source of supply charge to cover only the differential by which the cost of the treatment facility exceeds its net investment per customer in the balance of the Southern Division/Peoria single tariff pricing area. (IAWC Br., p. 26.)

The Alton source of supply charge passes muster whether measured against the general concepts of equity and non-discrimination or measured under the single tariff pricing philosophical principle of approximately equal reciprocity. As the Water Co. has put it in its initial brief, not only is the Alton source of supply charge equitable, but also "if the charge is not approved, a disproportionate rate increase will be assigned to large volume users under Staff's cost of service study " (IAWC, Br., p. 26).

But even if it did not measure up to these standards, where there are competitive forces, there is no room for the dogmatic and the doctrinaire. Pure cost of service rates and/or pure single tariff pricing cannot be maintained in the face of real world circumstances (*e.g.*, Trans., 10/26/00, pp. 106-08). The Staff in practice has recognized this fact. The Staff bent to some degree in its cost of service approach in response to real world circumstances (*e.g.*, ICC Br., pp. 34-5, 36), though not enough to sap competitive prices of their allure (*e.g.*, Trans., 10/26/00, p. 54). The Staff also bent to some degree in its single tariff pricing stance (*e.g.*, ICC Br., p. 32). And, the competitive tariffs deviated from both cost of service and single tariff pricing (*e.g.*, O'F Br., p. 21). It nevertheless still insists on strict adherence to single tariff pricing, in recommending the inclusion of the full Alton water treatment facility cost in single tariff pricing. Why does the Staff seriously risk pushing large water users into defection from the Water Co. and damaging loss to all ratepayers.[6] Where is the evidence that defections will not be the ultimate result? Where is there any evidentiary consideration of the effect on competition at all?

The IIWC is caught in a similar inconsistency. On the one hand, it counsels against the Alton source of supply charge solely as a dogmatic insistence on consistency with single tariff pricing (IIWC Br., p.14). On the other hand, it strongly advocates flexibility in rate design. It advocates flexibility on two grounds: (1) [g]iven the deferring circumstances that surround ratepayers throughout the State of Illinois, a one size fits all approach may not be workable (IIWC Br., p.13), and (2) given the significant rate increases over the past several years...the significant increase in rate base and impact on rates...coupled with the fact IAWC is experiencing serious and significant competitive pressures

[6] The Commission has drastically deviated from single tariff pricing with exceptionally low rates to head off such defections in the past on the theory of having prevented even greater loss to other ratepayers buying off the defection.

and that large volume customers in the Southern Division have competition options (IIWC Br., p. 13).

There should be much hesitation by the Commission before it allows the rates in rate blocks 3 and 4 to continue to rise, let alone aggravating the increase for no better reason than adherence to the doctrine of single tariff pricing. Dogmatic insistence on single tariff pricing in the Water Co.'s particular situation could prove very destructive, causing the loss of contributions to shared costs now made by large water users who have the opportunity to bolt the Water Co.'s system (and perhaps attract other Water Co. customers away in the process (IAWC Br., Trans., 10/26/00, p. 64) for a lower rate from the City of St. Louis or other competitive source.

CONCLUSION

As previously stated in O'Fallon's initial brief, granting of a rate increase in response to the Water Co.'s rate application should not be done without more care and proof regarding the practical effects, fairness, reasonableness and discrimination of the pattern of apportionment and distribution of the rate increase among the several classes of particular ratepayers. The present pending rate application of the Water Co. should be denied and the new rates cancelled. The Water Co. should be sent back to return with a much more developed rate application and with expanded evidence that can support it in conformity of applicable law.

To the extent that any part of the application is granted and the rates requested should be modified in accordance with the rest of O'Fallon's conclusion in its initial brief.

In any event, the proposed Order supplied by the Water Co. should not be approved. O'Fallon believes that the Order should be rejected in its entirety, but if the Hearing Officer

determines that it will proceed on the basis of the draft Order, then it should be modified and amended to conform to the points made in O'Fallon's initial brief.

Respectfully submitted,

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